IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1941.

IN THE MATTER

—OF—

MANHATTAN STEAM BAKERY, INC.,
Bankrupt.

IRVING J. WHITE, appearing specially,
Petitioner,

IRVING STEINMAN, as Trustee, NATHAN PEARLSTEIN and MANHATTAN BAKERIES, INC.,
Respondents.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

STATEMENT.

Some of the essential facts have been stated in the petition but an adequate statement would unduly prolong this brief. The affirmance of the order of the District Court was unanimous and two opinions were rendered (not yet reported) which are included in the return.

JURISDICTION.

The decisions affirming the order of the District Court were handed down on June 9th, 1941. The jurisdiction of this Court is invoked under the provisions of the Judicial Code (as amended), particularly Sections 237 and 240 (a) and under the Rules of Practice and Procedure now in force par-

ticularly Subdivision (b) of Section 38 [Revised Rules], the Bankruptcy Act and the rules concerning the same.

STATUTES INVOLVED.

The New York Personal Property Law, Sections 65 and 71; amendment of June 22, 1938, of the Bankruptcy Act [Chandler Act] (Sec. 70 (c) U. S. C. A., Title 11, Sec. 110 (c)); adding: "whether or not such creditor exists."

Article V in Addition to, and Amendment of, the Constitution of the United States; the material portions of which are set forth in the appendix.

ERRORS TO BE URGED.

POINT I.

The Circuit Court of Appeals erred in deciding that the Bankruptcy Court had jurisdiction of petitioner, or the *res*, or to entertain the petition of the trustee dated August 27, 1940, and to grant an order thereon (of the same date) directing Irving J. White (and others) after the State Sheriff's levy, to show cause before the Referee why the relief now had should not be granted. White appeared specially and challenged (a) the power of the referee to make the order; (b) service on White's attorney and not personally on White; (c) any equity action or special proceeding by way of an order to show cause; (d) jurisdiction of White or of the property involved and (e) the constitutionality of the proceeding as not constituting due process under the law.

The order of reference had no connection whatever with this order to show cause; the reference was directed by the District Court on June 28th, 1940; the order of reference was not made until September 20, 1940, after the Trustee's attempt to obtain jurisdiction of White by his order to show cause of August 27, 1940, served only on White's attorney.

The alleged submission of White to this jurisdiction resulting in the order of reference is based solely on his application to modify the stay of proceedings and such other (incidental) relief as might be just. His assertion of jurisdiction in the State Court is called a "consent" to bankruptcy jurisdiction. Here the sequence of events is very important:

1940

June 19, Creditors' meeting and tentative acceptance of Pearlstein's offer to purchase, subject to White's contract.

20, White obtains order to show cause returnable June 21, why the stay of his pending action should not be vacated.

21, Receiver and creditors obtain adjournment of above White application to June *28th*; and

22, Order confirming the sale is entered WITHOUT NOTICE, though the offer gave to 5 P. M. June 28th to close.

24, Pearlstein transfers his purchase to the new corporation Manhattan Bakeries, Inc., subject &c.

28, (Adjourned date) White asks leave to withdraw his application because the sale is now confirmed and complete, still subject to his contract and foreclosure thereof, and the District Court has voluntarily parted with possession of the *res* which he must now pursue in the State Court as against the purchaser and his transferee.

This leave is denied and a reference is directed, based on this alleged submission of White to the jurisdiction of the District Court. White had the right to pursue the purchaser and his transferee without the District Court's permission. No stay protected them and the causes of action against them

arose after the sale. The District Court could aid him *only before* the sale was judicially confirmed.

To protect his property White brought suit in the State Court against Pearlstein on July 1, 1940, and brought in the Manhattan Bakeries, Inc., a week later, and both appeared and answered in that action. He here obtained temporary stays against further disposition of the property, and when they expired gave the statutory bond of $12,000. and the Sheriff levied replevin on August 24, 1940. Now, when Manhattan Bakeries, Inc., was about to lose the free use of this expensive equipment, the Trustee springs into action and obtains, on August 27, 1940, on his petition, an order from the Bankruptcy Referee, staying White and the Sheriff and directing White to show cause why he should not be expropriated. White appears specially and protests the jurisdiction. On September 4, 1940, months after they had appeared and answered in White's State Court action, Pearlstein and Manhattan Bakeries, Inc., file a limited appearance with the Referee, consenting to White's expropriation, but without prejudice to their rights in ANY forum, and on September 20, 1940, almost a month after the State Court replevin, the order of reference is entered. The hearing was held October 2, 1940, and White again appeared specially and protested the jurisdiction; the Referee's report rendered on November 18, 1940, and confirmed by the District Court on January 13, 1941. Of course, all of these steps "In Bankruptcy" were taken after August 24, 1940, when replevin was levied.

Only possession of the *res* could confer any jurisdiction on the District Court. *In Re Baldwin*, 291 U. S. 610; *Lion Co.* v. *Kraratz*, 262 U. S. 77, p. 88; *Metcalf* v. *Barker*, 187 U. S. 177.

POINT II.

The Circuit Court of Appeals erred in deciding that the District Court, sitting in bankruptcy or otherwise, had summary jurisdiction to determine the validity of White's con-

tract, without having the actual or constructive possession of the *res*.

Its opinion creates the ghost of an "interest" in a lien which had passed, with the sale, and with the transfer of the goods. It says "the order whereby the 'lien is preserved for the benefit of the estate' * * * is somewhat misleading but serves as a sufficient description of the interest retained by the Trustee. Speaking accurately (*sic*), what is preserved is not the lien of White but an interest in the chattels equivalent thereto which the bankruptcy COURT never sold." What in the name of law is this imaginary interest? The concurring opinion is based on the theory that the "sale contract" (presumably that of the Bankruptcy Court to Pearlstein) is "the product of mutual mistake". No suit or application, in any way, to correct or modify THAT contract was ever instituted!

First Na. Bank v. *Chicago Co.*, 198 U. S. 280.

And by the same Circuit Court on almost identical facts. *In Re Rothschild*, 154 Fed. 194, 18 A. B. 682. Another case "on all fours" is *In Re Bluestone*, 174 Fed. 53.

Summary proceedings are ably defined *In Re Ballou*, 215 Fed. 810. That White did not abandon his claim did not amount to a consent to an exercise of jurisdiction, which he protested. *Louisville Co.* v. *Comingor*, 184 U. S. 18.

POINT III.

The question as to the validity of the refiling of White's contract could be raised only by a creditor having "by attachment or levy a lien" WITHOUT NOTICE. *Holt* v. *Crucible Co.*, 224 U. S. 262, 32 S. Ct. 414. Here the bankrupt had been through a reorganization proceeding in 1938 and the whole baking industry knew the actual conditions. No attempt to prove or offer of proof was made regarding the existence of a single creditor WITHOUT NOTICE. *U. S.* v. *Grogg*, 9 F.

(2) 424. This burden of proof was on the trustee. *In Re Pointer Brewing Co.*, 105 F. (2) 478; *In Re Douglas Lumber Co.*, 2 F. (2) 985, 3 A. B. R. ns 67. The Second Circuit held otherwise *In Re Master Knitting Corp.*, 7 F. (2) 11, where Hon. Learned Hand dissented, with an opinion citing the *Douglas* case (*supra*) and his dissenting opinion agrees with the law in New York State. *American Co.* v. *Najarian*, 195 N. Y. Supp. 555, 119 Misc. 219, citing *Seymour* v. *McKinstry*, 106 N. Y. 230. McKinney's Consol. Laws Vol. 40 (Pres. Prop. Law), p. 256, Sec. 65, note 9 citing *Craine Co.* v. *Alden Bank*, 218 App. Div. 263, 218 N. Y. Supp. 143; *N. Y. Title Co.* v. *Grossman, Inc.*, 142 Misc. 274, 253 N. Y. Supp. 533 affd. (no opinion) 236 App. Div. 665, 257 N. Y. Supp. 1031 and many others.

"Whether or not such creditor actually exists" was added by the Chandler Act in 1938, more than a year after White's contract was made and a year after it was actually in permanent default. The Act has been held not to be retroactive. *Ginsberg* v. *Lindel*, 107 F. (2) 721; (Nov. '39, C. C. A., 8) citing 209 U. S. 306, 314; 28 S. Ct. 537; 52 L. Ed. 804; *Holt* v. *Henley*, 232 U. S. 637.

POINT IV.

The Court below erred in undertaking to preserve to the Trustee "not the lien of White but an interest in the chattels equivalent thereto which the bankruptcy court never sold." What is this ghost of an "interest"? The sale was actually subject to White's contract and its foreclosure. The concurring opinion describes the situation as one of "mutual mistake" while mistake, if any, was not of a fact but a mistake of law and there was nothing "mutual" about it.

No order was obtained to permit a sale free and clear of encumbrances (so that claims might attach to the proceeds) or was an order made preserving the lien to the Trustee, because White's contract was considered valid, as it was in fact. *In Re Muhlhauser*, 121 Fed. 669 (C. C. A., 6).

The minutes of the sale show the Receiver's and petitioning Creditors' attorney saying: "There is a conditional bill of sale under foreclosure by I. J. White of $11,000." *i. e.*, $9,400. and interest. Mr. Midler (purchaser's attorney) "there are 18 or 19 trucks * * *. Other than that practically all the equipment in the place is subject to the I. J. White mortgage" and again the Receiver's attorney: "There are very few new creditors, * * * Most * * * appeared in the re-organization proceeding and if they do not know what the assets are certainly no one would know." White has been in the bakers' machinery business for many years; he installed this equipment at his substantial cost and forebore foreclosure for 32 months after default. Shall his indulgence cost him ten thousand dollars? He was a business man acting in good faith without lawyers. *In Re Sexton*, 225 U. S. 96; *S. & S. Gold Mines* v. *Seymour*, 153 U. S. 509.

Besides, the purchaser was entitled to know who would hold his obligation; whether White or the Trustee. But, of course, if the Trustee thought he had any such right as is now asserted, it would have been his duty to sell "free and clear" and not subject to White's contract *and* its pending foreclosure.

POINT V.

The Court below erred in that the bankrupt had no leviable interest in the chattels under New York law and, therefore, none the Trustee could acquire. Bankruptcy Act (Title 11, U. S. Code, Sec. 110 (5)). The law of the State is the law in bankruptcy. *Thompson* v. *Fairbanks*, 196 U. S. 516. Bankrupt had no leviable interest. *Baker* v. *Hill*, 250 N. Y. 484; *Whitney* v. *Biggs*, 156 N. Y. Supp. 1107, 62 Misc. 424; *Edwards* v. *Walker*, 293 N. Y. Supp. 1007, 162 Misc. 96 (Supp., p. 1010); *C. I. T. Co.* v. *Miklow*, 282 N. Y. Supp. 447, 157 Misc. 120. A state assignee for the benefit of creditors is not a creditor with a lien acquired by attachment or levy. *In Re Pelligrini*, 290 N. Y. Supp. 774, 248 App. Div.

526 (2nd Dept.), citing *Kane Co.* v. *Kinney,* 174 N. Y. 69; *Creamery Co.* v. *Horton,* 165 N. Y. Supp. 257, 178 App. Div. 467, approved and followed *In Re Lloyd Co.,* 11 Supp. (2) 223, 256 App. Div. 965 (mem.).

If valid against the state assignee it is valid against the Trustee. *Humphrey* v. *Tatman,* 198 U. S. 91; *Hewitt* v. *Berlin Wks.,* 194 U. S. 296, citing *In Re Economical Printing Co.,* 110 Fed. 514, in which authorities are discussed, including *Sheldon* v. *Wickham,* 161 N. Y. 500.

The right to lien was lost if not taken before bankruptcy. *Detroit Trust Co.* v. *Pontiac Bank,* 237 U. S. 196; *Holt* v. *Crucible Co.,* 224 U. S. 252 (*supra*). The Trustee takes subject to liens valid against the creditors *whom he represents. In Re Border Bank* v. *Coupland,* 240 Fed. 365 (C. C. A., 5); *In Re Dagwell,* 263 Fed. 406; *In Re West Side Auto Co.,* 279 Fed. 301. Sections 67 and 70 of the Bankruptcy Act provide only for subrogation regarding liens acquired by LEGAL action and, in this case, there is neither reason for, nor right to, subrogation.

REASONS RELIED UPON FOR ISSUANCE OF THE WRIT.

1. The District Court parted with jurisdiction when it parted with the *res;* it had jurisdiction of neither the person of petitioner nor of the *res* in this proceeding.

2. The State Supreme Court has exclusive jurisdiction of the parties and possession of and sole jurisdiction over the *res* where the Trustee may interplead and assert his claim.

3. This summary proceeding is without legal basis and there is no authority for subrogation in this case.

4. Bankrupt had no leviable interest in the *res* and therefore the Trustee could acquire none.

5. The judicial confirmation of the sale is *res adjudicata* as to the validity of the White contract.

6. The amendment, set forth, of the Chandler Act is not retroactive.

7. The burden of proving want of actual notice on the part of any creditor, of White's contract, was on the Trustee.

8. Conditional contracts raise questions of *title;* not of lien.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the fundamental questions involved on this appeal are of sufficient importance to require the exercise of this Court's supervisory jurisdiction by a writ of certiorari.

Dated, July 21st, 1941.

JOHN P. McGRATH,
Counsel for Petitioner,
appearing specially.